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IN THE

Supreme Court of the United States

LEHMAN BROTHERS BANK, FSB,
Petitioner,

v.

STATE BANK COMMISSIONER,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Delaware

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BRIEF OF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONER

TODD A. LARD
Counsel of Record
DOUGLAS L. LINDHOLM
FREDRICK J. NICELY
JANA L. MALONE
BOBBY L. BURGNER
J. HUGH MCKINNON
COUNCIL ON STATE TAXATION
122 C St. N.W., Suite 330
Washington, D.C. 20001
(202) 484-5222

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BRIEF OF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONER

INTEREST OF *AMICI CURIAE*

This brief *amicus curiae* in support of Petitioner (Lehman Brothers Bank, FSB) is filed on behalf of the Council On State Taxation ("COST").[1] COST is a

[1] The parties have consented to the filing of this brief. Counsel of record for all parties received notice at least 10 days prior to the due date of the *amicus curiae*'s intention to file this brief. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission.

non-profit trade association formed in 1969 to promote equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities. COST represents more than 600 of the largest multistate businesses in the United States; companies from every industry doing business in every state.

COST's members are concerned that the risk of multiple taxation will become a reality if this Court allows Delaware's unapportioned tax to stand. A state tax left standing by this Court serves as a convenient recipe for other states seeking new revenue sources, because "[i]f [one state] is free to exact . . . a tax, other states to which the commerce extends may, with equal right, lay a tax similarly measured." *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939). *See also McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 48 (1940). That is precisely why "[t]he jurisdiction of [one state] to tax 'must be determined on a basis which is consistent with the like jurisdiction of other States.'" *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 326 (1944) (Stone, C.J., dissenting) (quoting *Johnson Oil Ref. Co. v. Oklahoma*, 290 U.S. 158, 162 (1933)). If the Court leaves the decision of the Delaware Supreme Court standing without guidance, other states will undoubtedly adopt similarly unsound theories of taxation, exacerbating multiple taxation of income.

STATEMENT OF THE CASE

This case raises the issue of whether a state can tax all of the income of an interstate entity based simply on the determined fact that the entity has a domicile in the state for regulatory purposes. The Delaware Supreme Court held that Delaware could tax all the income of a bank engaged in interstate

business based on the sole fact that the bank was domiciled in Delaware. The commercial domicile of Lehman Brothers Bank ("Bank") was disputed in the lower court. The Delaware Bank Commissioner argued that the Bank was commercially domiciled in Delaware based on the Bank's listing of Delaware as its home state on its federal stock charter. The Bank argued it was domiciled in New York, the state where the Bank's operations are managed. In affirming that the Bank is domiciled in Delaware without any branches or subsidiaries in other states, the Delaware Supreme Court held that Delaware could tax 100% of the Bank's income. The ruling contradicts the standards from this Court that the Commerce Clause and the Due Process Clause mandate state taxes be fairly apportioned to only tax those activities conducted within the taxing state.

SUMMARY OF ARGUMENT

The Delaware Supreme Court has incorrectly interpreted *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) to sustain Delaware's tax on the Bank. Delaware's taxing scheme on a Delaware-domiciled bank with income clearly subject to taxation in other states violates the mandates of the Due Process Clause and the Commerce Clause. A state simply cannot tax 100% of income that is generated in interstate operations taxable in multiple states. The impact of an unapportioned income tax on multistate business is intensified in an era when states increasingly assert that businesses must pay tax to a state simply because they have a limited economic presence in the state.

ARGUMENT

Petitioner lays out compelling legal reasons for granting *certiorari* in this case: The Delaware Court's unwise departure from this Court's precedent in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *Central Greyhound*, 334 U.S. 653 (1948), and *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931); and the conflict among states as evidenced in decisions like *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia*, 823 A.2d 108 (Pa. 2003).

Amicus will not repeat all of these points. Instead, it will focus on additional legal and policy considerations that add gravitas to this matter.

I. THIS COURT SHOULD GRANT REVIEW IN ORDER TO PRESERVE FUNDAMENTAL COMMERCE CLAUSE APPORTIONMENT REQUIREMENTS THIS COURT HAS LONG RECOGNIZED

The Delaware Supreme Court wrongly states that under this Court's decisions, multiple taxation on the same income is permissible when a "structural apportionment framework" results in the imposition of tax on 100% of the income of an entity when only 2% of the entity's activity occurred within Delaware. Implicit within the Delaware court's holding is the recognition that the "structural apportionment framework" refuses any bank with a Delaware "home office" or "principal place of business" the right to apportion income among the jurisdictions in which it does business. This Court has long considered a state's unwillingness to allow the apportionment of income or other tax bases where the business domicile is within the state to be violative of the Com-

merce Clause. In the words of Chief Justice Stone in the context of intangibles, "[w]hile the existence of a business domicile has been thought to afford a basis for the state taxation of intangibles, on the theory that they have become localized there. . . . the taxation of intangibles of interstate [companies] is subject to the rule of apportionment wherever the tax without [apportionment] would subject the commerce to the burden of multiple state taxation." *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 318 (1944) (Stone, C.J., dissenting) (*citing Southern Ry. v. Kentucky*, 274 U.S. 76, 81 (1927); *Wallace v. Hines*, 253 U.S. 66, 69-70 (1920); *Meyer v. Wells, Fargo & Co.*, 223 U.S. 298, 300 (1912); *Fargo v. Hart*, 193 U.S. 490, 499 (1904); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 223-25 (1897)).

In the landmark case *Pullmans Palace Car Co. v. Pennsylvania*, 141 U.S. 18 (1891), this Court rejected the Middle Ages rule for personal property expressed in the maxim *mobilia sequuntur personam* (movables follow the person) and the proposition that personal property was only subject to taxation at the owner's domicile. The Court reasoned "[t]he result of holding otherwise would be that, if all the states should concur in abandoning the legal fiction that personal property has its *situs* at the owner's domicile, and in adopting the system of taxing it at the place at which it is used and by whose laws it is protected, property employed in any business requiring continuous and constant movement from one state to another would escape taxation altogether." *Id.* at 24. *See also Union Refrigerator Transit v. Kentucky*, 199 U.S. 194 (1905) (holding the mere fact that a company was incorporated in Kentucky did not allow Kentucky to tax personal property located in other states).

The powerlessness of a domicile state to assert its full taxing power over a domiciled company was also addressed by the Court in *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952). In that case, the Court held that Ohio could not tax 100% of the taxpayer's vessels where it was shown that the vessels were subject to apportionment. *Id.* at 384. Based on the Court's prior holding in *Ott v. Mississippi Val. Barge Line*, 336 U.S. 169 (1949), where the Court held that vessels in inland waters could be apportioned, the Court in *Standard Oil* rejected Ohio's premise that it could fully tax the taxpayer's vessels based on the taxpayer's domicile in that state and held such tax on property not located in Ohio was unconstitutional.

The Court noted, "[t]he rule which permits taxation by two or more states on an apportionment basis precludes taxation of all the property by the state of domicile . . . Otherwise there would be multiple taxation of interstate operations and the tax would give no relation to the opportunities, benefits, or protection which the taxing state gives those operations." *Standard Oil Co.*, 342 U.S. at 385-386. Importantly, the Court in *Standard Oil* distinguished a prior case, *Northwest Airlines, Inc. v. State of Minnesota*, 322 U.S. 292 (1943), on grounds that in *Northwest Airlines* the taxpayer had not shown its property acquired a taxable situs in another state.[2]

This Court in *Northwest Airlines* upheld, under a version of the "home port" doctrine, an unapportioned

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[2] While it can be argued that *Standard Oil* dealt with an ad valorem tax and not an income tax, the conclusion does not differ for income taxes. The Court in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 at 443-444 (1980) rejected the taxpayer's notion that only the taxpayer's domicile state, New York, could tax the taxpayer's dividends.

Minnesota tax on the entire fleet of airplanes used by a Minnesota domiciliary in interstate commerce. Subsequently, this Court substantially eroded the rationale of that decision in *Braniff Airways, Inc. v. Nebraska Bd. of Equalization*, 347 U.S. 590 (1954), which held that a non-domiciliary state could impose an apportioned tax on the value of an interstate air carrier's flight equipment. The "home port" doctrine, at least for moving equipment other than oceangoing vessels, "has yielded to a rule of fair apportionment among the States." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 343, 442 (1979). Indeed, the Court has treated Chief Justice Stone's dissenting opinion in *Northwest Airlines* and its mandate for apportionment as an accurate statement of current Commerce Clause doctrine. *Id.* at 443, 452 n.17, 455.

By refusing to allow the Bank to apportion its income, the Delaware court ignored the logic of the *Northwest Airlines* dissent. The Bank has operations in other states and is afforded with opportunities, benefits, and protection from other states. Because the Bank is subject to apportioned taxation in other states, the *Northwest Airlines* dissent teaches that the domicile state is precluded from taxing all of the Bank's income. As this Court held in *Hunt-Wesson, Inc. v. Franchise Tax Board of California*, 528 U.S. 458 (2000), holding California's disallowance of interest expense to a nondomiciliary corporate taxpayer violated both the Due Process Clause and the Commerce Clause, Delaware's law at issue in this case "constitutes impermissible taxation of income outside its jurisdictional reach." *Id.* at 468. Not allowing a taxpayer to apportion its income also represents a clear "attempt to tax property beyond the jurisdiction of the state, and to throw an uncon-

stitutional burden on commerce among the states." *Fargo v. Hart*, 193 U.S. 490, 502 (1904).

As the Court articulated in *Moorman Industries*, "States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that State." *Moorman Mfg. Co. v. Bair* 437 U.S. 267, 274 (1978) (citing *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931) (quotations omitted)). However, in this case the appropriateness of an apportionment formula is not at issue because there is simply no apportionment method available to the Bank. Delaware taxes 100% of the Bank's income based solely on the Delaware Bank Commissioner's finding that the Bank was domiciled in Delaware and the Commissioner's determination that the Bank had no out-of-state branches or subsidiaries. As a result, the Bank is impermissibly subject to tax by Delaware in a manner that is completely out of proportion with the business it transacted in Delaware. The Bank was not conducting business only in Delaware; in fact, it was conducting the vast majority of its business in other states.

As the Petitioner thoroughly argues, the Delaware court's holding also runs contrary to *Goldberg v. Sweet*, 488 U.S. 252 (1989), where this Court held "the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." The Bank is engaged in an interstate banking business. It transacts a significant amount of business outside of Delaware. The Delaware court's holding that it can tax 100% of the Bank's

income reaches far "beyond that portion of value that is fairly attributable to economic activity with the taxing State." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).[3] To be sure, the potential for duplicative taxation is not speculative.

While this Court has sustained the states' ability to apportion income of an interstate business, the Court has also struck down the rigid use of apportionment formulas that lead to distortive results. For example, the Court did not allow Missouri to rigidly use its millage apportionment on rolling stock when it led to a distortive result (attempting to tax 8.24% of the rolling stock when the taxpayer demonstrated only 2.71% was in Missouri), *Norfolk and W. Ry. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968). Delaware's statutory formula leads to the same "unconscionable and unconstitutional result." *Id.* at 321. This Court should grant *certiorari* to squarely address this issue of apportionment and hold that Delaware's unapportioned tax on the Bank violates the fair apportionment requirement of *Complete Auto*.[4]

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[3] To justify its tax regime, the Delaware Supreme Court substantially relies on a decision by the Supreme Court of Rhode Island, *Commercial Credit Consumer Services v. Norberg*, 518 A.2d 1336 (R.I. 1986), which was decided before this Court ruled in *Jefferson Lines*. In *Norberg*, the Rhode Island court erroneously concludes that Rhode Island's tax law did not subject a corporation to multiple taxation on the same income. While Rhode Island allowed a corporation to deduct taxes paid to another state, it still taxed the same income because it did not exclude that income from taxation.

[4] Delaware is not the only state that refuses to allow apportionment. *See e.g.* W. Va. Code § 11-24-7 (specifying that financial organizations that are commercially domiciled in West Virginia must apportion 100% of income to West Virginia).

II. THE IMPACT OF THE DELAWARE COURT'S FLAWED DECISION IS AMPLIFIED BY A TREND AMONG STATES TO ASSERT THAT COMPANIES ARE TAXABLE IN THEIR STATE BASED SOLELY UPON AN ECONOMIC PRESENCE

The impact of an unapportioned income tax on multistate business is intensified in an era when states increasingly assert that businesses must pay tax to a state simply because they have a limited economic presence in the state. When multiple states are allowed to impose unapportioned taxes on the same income by asserting an economic nexus theory, duplicative tax will certainly occur.

In *Quill Corp. v North Dakota,* 504 U.S. 298 (1992), this Court reiterated what constitutes "substantial nexus" for purposes of Commerce Clause analysis; citing from the Court's prior holding in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967), it requires a physical presence in the taxing state. The Court also expressed its desire for "a rule [that] firmly establishes the boundaries of legitimate state authority to impose . . . taxes. . . *Quill* at 315.

In this case, the Bank has the requisite "substantial nexus" under *Quill* to be subject to tax in more than one state. Apart from Delaware where it had 11 to 13 employees, the Bank had an office with 20 to 25 full-time employees in New York and an additional 90 dual employees located in New York and Colorado that also worked for other affiliates of the Bank. App. To Pet. Cert. 148a. The Bank also had an affiliate conducting extensive mortgage activity in California.

Thus, it is not disputed that the Bank has the requisite physical presence to be subject to taxation in not only Delaware, but also New York and other states. The record demonstrates that over $106 million in state and local income taxes were paid for the four years at issue in this case. Petr.'s Br. 12.

Most troubling to the *amicus*, however, is the impact of Delaware's position in states where the Bank does not have physical presence. State courts and legislatures continue to scribe exceptions to the physical presence nexus requirement espoused in *Quill*. Rather than relying on the *Quill* physical presence standard, states are asserting that non-sales and use taxes (e.g., income and gross receipts taxes) can be imposed on taxpayers using the lower threshold of economic presence. While we find serious fault and consternation with the legality of an economic presence standard—which has never been upheld by this Court—the suspect standard has been considered to pass constitutional muster by the highest courts in New Jersey, South Carolina, and West Virginia.[5] The use of this low nexus threshold

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[5] *See Lanco, Inc. v. Director*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 127 S. Ct. 2997 (2007); *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. 2004), *cert. denied*, 546 U.S. 821 (2005); *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993); *Tax Comm'r of West Virginia v. MBNA America Bank NA.*, 640 S.E.2d. 226 (W.V. 2006), *cert. denied sub nom.*, *FIA Card Services NA v. Tax Comm'r of West Virginia*, 127 S. Ct. 2997 (2007). Lower state courts have also upheld an economic nexus standard. *See Bridges v. Geoffrey, Inc.*, No. 2007 CA 1063, 2008 WL 399205 (La. Ct. App. Feb 8, 2008); *Kmart Props., Inc. v. Taxation & Revenue Dep't of N.M.*, 131 P.3d 27 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22 (N.M. 2005); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632 (Okla. Civ. App. 2005).

in order to impose taxes on out-of-state businesses only intensifies the Bank's and other taxpayers' exposure to taxation in a multitude of states; fueling the need for this Court to affirm that states must fairly apportion their taxes imposed on interstate activities.

CONCLUSION

In conclusion, this Court should extirpate any concept that a state, based on a conclusion that a business is commercially domiciled in the state, can tax 100 percent of the income earned by the business when such income is clearly subject to taxation in other states on an apportioned basis. *Amicus* respectfully requests the Court to review the Delaware Supreme Court's decision because it contravenes both the Due Process Clause and Commerce Clause by not affording the Bank with any meaningful apportionment of its income to reflect its activities conducted outside of Delaware.

Respectfully submitted,

TODD A. LARD
Counsel of Record
DOUGLAS L. LINDHOLM
FREDRICK J. NICELY
JANA L. MALONE
BOBBY L. BURGNER
J. HUGH MCKINNON
COUNCIL ON STATE TAXATION
122 C St. N.W., Suite 330
Washington, D.C. 20001
(202) 484-5222